the overall value of real estate in a particular market. The RTC has been advised by in-house and outside experts to consider local economic conditions when planning an auction.

While auctioning has proven to be an effective mechanism for the rapid sale of real estate assets, the RTC's first attempt at an auction was canceled. The highly publicized National Satellite Auction was scheduled to take place in November of 1990. It is believed that the auctioning firm selected by the RTC was not prepared to conduct an auction which was so large in scope. The plan was to offer-up for auction nearly $300 million in assets, while bidding was conducted simultaneously on three continents, via satellite.

Even if the auction had occurred, the prospects for success were limited. The bulk of assets for sale were hard-to-sell commercial real estate properties, including hotels and office towers in glutted markets and empty shopping centers. In the typical sales process, investors allocate substantial time and financial resources to evaluate investment properties only after a conditional sales contract has been secured. Because these properties were low grade to begin with, and there are no conditional sales contracts at an auction, per se, prospective investors would have been presented with an unusually risky investment proposition. The likelihood of closing a sale would have been made even more tenuous by the uncertainty in securing financing for commercial real estate properties.

While the obstacles encountered in planning the National Satellite Auction suggest that auctions may be more effective in the sale of specific types of properties within a local market, the RTC is carefully planning a second commercial real estate auction. In an effort to clear its books of residential properties valued at under $100,000, the RTC is planning a series of 80 to 90 auctions in various cities throughout the nation over the next six months. These auctions are being managed by local auctioneers who, the RTC believes, are highly skilled at selling and have a good feel for property values and assets in their own markets.

Auctioned assets will be offered on a no-reserve absolute basis, that is with no minimum price, as long as the real estate is valued at less than $100,000 and the property has been widely exposed in the market. The RTC believes that the quick disposition of these small assets will maximize returns by freeing up staff to concentrate on large sales.

The RTC successfully carried out its first big residential auction in Phoenix, Arizona shortly after the failure of the first scheduled auction. Asking prices were roughly 20% below the price original owners or builders paid to buy or build the homes. On average, properties were sold for 78% of the asking price. These prices were comparable to those being paid for residential properties in many private auctions. Since market-level prices were achieved in Phoenix, the RTC is hoping to allay the fear that the RTC would drive real estate values down by selling too low in auction. This auction has been marked as a forward step in disposing of the RTC's large portfolio of residential real estate properties.

Liberalized Pricing Policy: The RTC has recently adopted a new, flexible pricing policy which will allow it to quickly adjust prices in response to local market conditions. Local brokers heavily criticized the RTC's original appraisal system, because they believed prices did not reflect local market conditions, and the system limited their ability to adjust prices to these conditions. Formerly, real estate prices could be reduced by only 20% of the initial appraisal value if a sale did not occur after nine months. As a result, offers lower than 80% of appraised value could not be accepted until a new appraisal was ordered, supporting the lower price. Under the new policy, the RTC does not have to incur the expense of ordering a new appraisal or delay acceptance of an offer until a new appraisal is completed. The RTC will continue to rely on appraisals, but will authorize write-downs from appraisals of up to 20% immediately, 40% after 6 months and 50% after 18 months. The new policy will provide local agents with increased discretion to negotiate discounts.

Portfolio Sales: The RTC has developed a new strategy to sell approximately $100 billion of assets, many of which are commercial properties, for which there is no ready market. The RTC is prepared to negotiate the sale of office buildings, warehouses, golf courses and marinas, in packages valued at $100 million or more. These packages will be offered in two forms, either as pools having similar characteristics, such as a collection of hotel properties, or a collection of diverse assets. In

marketing the former, the RTC will advertise the characteristics of the pool, and, based on investor response, select the best proposal and negotiate a final sale. Under the latter approach, the RTC will construct a pool of assets, and solicit offers for that specific portfolio. In some instances, discounted prices will be offered to buyers who agree to provide payments to the RTC from the earnings of the assets for a negotiated period of time. Because there is a limited field of purchasers for such large sales, the RTC is identifying only those investors who can and would have an interest in buying large amounts of property.

The properties selected for these portfolios have been marketed individually for six months and have not sold. L. William Seidman, Chairman of the RTC, refers to the current pricing policy toward hard-to-sell assets as a "Filene's Basement" approach, that is the price continues to fall until it attracts a buyer. Thus the price tag on a portfolio is equal to the sum of the discounted prices on the assets contained in the portfolio.

To help facilitate portfolio sales, the RTC is offering seller financing to those who qualify. While the RTC is willing to entertain proposals to group houses, condos or small commercial buildings together in bulk sales, its main market strategy remains to sell these properties individually.

Local Economic Impact: Concerns have been raised that the RTC's disposal of properties could harm local markets. It's argued that a quick sell-off of properties could depress prices in local markets, not only hurting private owners trying to sell competing properties, but also reducing the value of otherwise healthy thrifts' portfolios to the point that they, too, become sucked into insolvency. This, of course, would only contribute to the problem by requiring more taxpayer assistance in meeting depositors' claims and adding more properties for the RTC to sell.

Yet there are reasons to believe that, in most cases, the impact on local markets will be minimal, especially in the single-family mortgage market. The overriding reason is that, while the amount of property the RTC has to sell is enormous, it's minute in comparison to the nation's housing stock and generally manageable relative to the local market. Additionally, the sales will not transpire overnight, but over a period of a few years. There are areas of the country, however, where a quick sell-off may not be a good idea, particularly in the six states which account for over 80% of the RTC's property holdings: Colorado, Oklahoma, Texas, Louisiana, Arizona and Florida. An empirical study by Vandell and Riddiough suggests that the RTC should remain cautious about selling single-family housing in local markets that show few signs of recovery in housing activity and prices. For markets with a housing sector already on the rebound, an approach that's too cautious may be a detriment to the necessary pricing adjustments in the housing markets. This would prolong the uncertainty in the market, making the adjustment process more difficult and perhaps lead to greater default rates in the long run.

The authors also warn that selling a concentration of single-family homes at low prices or with subsidized financing, while advancing the affordability goals of the RTC, may cause further disruption in the affected neighborhood. The lower housing values may lead current families to perceive a loss of value in their homes, perhaps leading some homeowners to move to other areas.

Because of the investment nature of the industry, the impact on commercial property is less difficult to assess, according to Vandell and Riddiough's analysis. Unlike the RTC's single-family holdings, which tend to be concentrated in new suburban developments, most of the RTC's commercial properties are scattered about metro areas. Since the construction of these buildings led to the thrifts' difficulties, many are presumably ill-conceived. Consequently, the authors argue that there should be little impact on the investment grade market. Additionally, prices may not go much lower since the oversupply problem is already reflected in the current prices. To support their conclusions, Vandell and Riddiough point to the Dallas properties liquidated by the FSLIC in the late 1980s which sold at 120% to 130% of their appraised value (although admittedly the appraisals may have been conservative). Abrupt price changes, or price shocks, usually are the result of an unanticipated event; the sale of the RTC's properties is hardly unexpected. What may cause problems is how quickly the properties are sold if the market incorrectly anticipates how low the prices of some buildings will have to go before they sell. In this case, time will be required for the market to

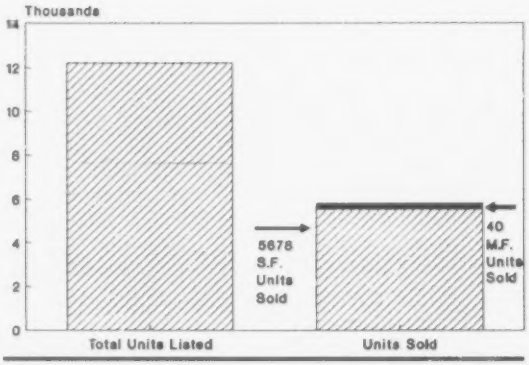
reassess the values of the area's commercial properties.

Affordable Housing: To provide homeownership and rental opportunities for low-income individuals, the RTC has established the Affordable Housing Disposition Program. The program provides low-income individuals with the opportunity to purchase properties which meet certain appraisal criteria before they are available to the general public. Properties in the following price ranges are offered exclusively to low-income individuals for a period of 90 days: single-family residences appraised at $67,500 or less; $76,000 for a duplex; $92,000 for a triplex; and $107,000 for a fourplex. These properties are offered to buyers who have an adjusted income which is less than 115% of the area median income and who intend to occupy the house as their principal residence. The RTC also offers these properties to public agencies and nonprofit organizations who either agree to resell the units to lower-income individuals (families and individuals whose incomes do not exceed 80% of area median income) or provide rental housing which is affordable to lower-income individuals for the remaining useful life of the property. If a qualified nonprofit, public agency or low-income family does not make an offer within the 90-day period, then the RTC may sell the property to any qualified purchaser.

The RTC has also provided for the sale of multifamily properties which meet specific criteria under the Affordable Housing Disposition Program. Multifamily properties which are eligible for the program contain more than four dwelling units which have appraisal values not exceeding: $29,500 for an efficiency; $33,816 for a one-bedroom unit; $41,120 for a two-bedroom unit; $52,195 for a three-bedroom unit, and $58,392 for a unit containing four or more bedrooms. For the first 90 days, multifamily properties will be sold exclusively to buyers who agree to make at least 20% of the units available to very low-income families (families and individuals whose incomes do not exceed 50% of area median income) during the remaining useful life of the property. Additionally, at least 35% of the units must be available to lower-income families (families and individuals whose incomes do not exceed 80% of area median income). If the 90-day period has elapsed without an offer from a qualified purchaser, the RTC may sell the property to any qualified purchaser without these restrictions.

The Progress of Affordable Housing Sales

Holdings and Sales



Prospective buyers and properties which qualify for the Affordable Housing Disposition Program but are believed to be ineligible for private sector financing may utilize the RTC's seller-financing program. Under the RTC's Affordable Housing Seller-Financing Program, the terms of financing are more relaxed than conventional loan programs. For example, the downpayment required for the transaction will not, in many instances, exceed 5% of the purchase price. To ease the costs associated with the sales transaction, the RTC will often pay all or part of the closing costs. Of the $7.0 billion allocated for seller financing in early December 1990, the amount of $250 million has been reserved for affordable housing.

The RTC is also offering properties at no charge to municipal housing agencies and nonprofit housing groups. These properties must either have an appraised value under $5,000 or be deemed to have less value than what it would cost to maintain them while they are in the hands of the federal government. Those properties that don't sell or that cost more to manage than they are worth will be given away. An expected 2,000 to 3,000 will be donated to states or nonprofit organizations.

Working with the RTC: The RTC is drawing upon the expertise and services of the private sector in liquidating the assets of failed thrifts. Among the many types of services employed by

the RTC, there are countless opportunities for real estate brokerage and appraisal firms.

The first step for any broker who wishes to sell RTC-owned assets is to contact the nearest RTC regional office and to register with the RTC's Asset Contracting Division. All interested brokers must complete the Contractor Registration questionnaire. The RTC will only contract with brokers possessing all of the licenses necessary to sell real estate. Of particular interest to the RTC are those brokers who have demonstrated an expertise in the marketing and sale of real estate assets in the geographic area in which they plan to sell RTC-owned assets. Commission fees are negotiated at the time the asset is listed with the broker. An asset's complexity, location, and marketability are the three primary factors considered in determining commissions.

While there exist many opportunities for real estate practitioners, the bureaucratic nature of the agency has proven to be a hindrance for many private sector contractors wishing to work with the RTC. For example, many real estate brokers are discouraged by the RTC's sales contracts, which are complex and contain no variation for local laws. To address this concern, the RTC is currently reviewing all contracts to ensure that they are comprehendible and conform to standard local practice. Secondly, many brokers believe that the RTC's appraisal of property values does not reflect local market conditions, particularly for commercial real estate properties. In an effort to reform its appraisal mechanism, the RTC has liberalized its pricing policy, relying on the discretion of local experts in determining real estate property values. Finally, the RTC has been criticized for its inability to provide timely, accurate and complete information on assets. The RTC is currently preparing an on-line, real estate information system in response to these problems.

Several local Realtor® associations have initiated programs designed to help their members work effectively with the RTC. The Houston Association of Realtors® recently introduced an RTC helpline for its members. The helpline feeds directly into the RTC's Gulf Coast Sales Center and provides Realtors® with fast answers to specific questions about RTC procedures and properties. To facilitate the exchange of ideas between association members and RTC officials, the association has planned several luncheon meetings. The association has also arranged an agreement with the RTC whereby all RTC-held commercial properties are listed on the local Commercial Multiple Listing Service.

The Dallas Association of Realtors® has also established a helpline to provide general information on how to work with the RTC. The association also sponsors joint seminars with the RTC. These seminars provide information on working with the RTC, with some focusing specifically on the needs of real estate practitioners who specialize in commercial and investment real estate.

To receive additional information on working with the RTC, contact: Fannie White, Government Relations Division, National Association of Realtors®, (202) 383-1093 and request a copy of *How To Do Business with the Resolution Trust Corporation.*

by Kimberly A. Martin
Research Economist
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U.S. Economic Outlook: June 1991

	90.4	91.1	91.2	91.3	91.4	92.1	92.2	92.3	1989	1990	1991	1992	1993
U.S. Economy													
Annual Growth Rate													
Real GNP	-1.6	-2.6	0.2	2.0	2.5	3.6	3.9	4.0	2.5	1.0	-0.3	3.0	2.7
Industrial Production	-7.2	-9.6	-0.2	1.1	3.1	4.4	6.2	7.2	2.6	1.0	-2.8	4.2	4.9
Civilian Employment	-0.9	-2.4	1.1	1.2	1.0	1.5	1.7	2.0	2.0	0.5	-0.5	1.5	1.5
GNP Inflation Index	2.8	5.2	3.7	3.7	3.1	3.3	2.7	3.0	4.1	4.1	3.9	3.2	3.1
Consumer Prices	7.0	3.5	2.5	3.3	3.6	3.4	3.3	3.9	4.8	5.4	4.4	3.4	3.6
Value of the U.S. Dollar	-19.0	8.0	38.4	4.4	3.5	2.5	1.7	1.2	6.2	-9.6	1.8	4.4	-0.6
Percent													
Mfg. Capacity Utilization	80.8	78.0	77.5	77.4	77.7	78.3	79.3	80.5	84.0	82.3	77.7	79.9	82.8
Civilian Unemployment	5.9	6.5	6.8	6.9	6.9	6.8	6.6	6.3	5.3	5.5	6.8	6.5	6.0
Percent of GNP													
Federal Tax Receipts	20.4	20.5	20.5	20.5	20.5	20.7	20.7	20.7	20.2	20.3	20.5	20.7	20.7
Federal Expenditures	23.7	22.6	22.9	23.7	24.0	24.1	23.9	23.6	22.8	23.3	23.3	23.8	23.2
Federal Budget Deficit	-3.3	-2.1	-2.4	-3.2	-3.4	-3.5	-3.2	-3.0	-2.6	-3.0	-2.8	-3.1	-2.6
Interest Rates, Percent													
Federal Funds Rate	7.7	6.4	5.8	5.9	5.9	5.9	6.1	6.4	9.2	8.1	6.0	6.3	6.8
3-Month T-Bill Rate	7.0	6.0	5.5	5.5	5.7	5.7	5.8	6.1	8.1	7.5	5.7	6.0	6.2
Prime Rate	10.0	9.2	8.7	8.5	8.5	8.6	8.8	8.8	10.9	10.0	8.7	8.7	8.8
Discount Rate	6.9	6.2	5.7	5.5	5.5	5.5	5.7	5.8	6.9	7.0	5.7	5.7	6.1
Corporate AAA Bond Yield	9.3	8.9	8.8	8.6	8.5	8.5	8.6	8.7	9.3	9.3	8.7	8.6	8.6
30-Year Government Bond Yield	8.5	8.2	8.3	8.0	8.0	8.0	8.1	8.2	8.4	8.6	8.1	8.1	8.2
Mortgage Rates, Percent													
30-Year Fixed Rate	10.0	9.5	9.4	9.3	9.1	9.1	9.0	9.0	10.3	10.1	9.3	9.0	8.9
1-Year Adjustable	8.1	7.6	7.2	7.1	7.0	7.0	7.0	7.0	9.3	8.4	7.2	7.0	7.0
Home Sales & Starts													
Thousands													
Total Single-Family Sales*	3,879	3,796	4,069	4,196	4,271	4,399	4,459	4,548	4,442	4,179	4,083	4,501	4,661
Existing Single-Family Sales	3,117	3,093	3,290	3,383	3,429	3,51[illegible]	[illegible]	3,590	3,467	3,305	3,299	3,567	3,677
New Single-Family Sales	470	466	519	542	581	59[illegible]	[illegible]3	620	654	533	527	612	651
Housing Starts	1,042	913	989	1,029	1,077	1,12[illegible]	[illegible]95	1,259	1,381	1,203	1,002	1,215	1,314
Single-Family Units	786	724	803	838	868	915	948	988	1,005	901	808	962	1,014
Multi-Family Units	256	189	186	191	209	214	248	271	376	302	194	253	300
2-4 Family Units	31	31	30	31	34	35	40	44	56	37	31	41	49
5+ Family Units	225	159	156	160	175	179	207	227	320	264	163	212	251
Mobile Homes Shipped	178	161	165	169	170	175	176	177	199	188	166	175	168
Percent change -- Year Ago													
Total Single-Family Sales	-13.8	-15.2	-3.9	1.7	10.1	15.9	9.6	8.4	-4.4	-5.9	-2.3	10.2	3.6
Existing Single-Family Sales	-11.9	-10.2	-2.2	2.6	10.0	13.5	7.6	6.1	-3.6	-4.7	-0.2	8.1	3.1
New Single-Family Sales	-27.9	-22.0	-3.8	3.6	23.6	26.9	16.7	14.3	-3.3	-18.5	-1.0	16.2	6.4
Housing Starts	-22.9	-36.3	-17.8	-9.0	3.3	23.6	20.8	22.3	-7.2	-12.9	-16.7	21.3	8.1
Single-Family Units	-20.9	-32.0	-10.4	-2.1	10.3	26.4	18.0	17.8	-7.2	-10.4	-10.3	19.1	5.4
Multi-Family Units	-28.4	-48.7	-39.5	-30.3	-18.3	12.8	33.0	41.8	-7.2	-19.7	-35.8	30.6	18.3
2-4 Family Units	-42.2	-28.7	-30.4	-3.3	9.2	12.8	33.0	41.8	-5.1	-32.8	-15.9	30.6	18.3
5+ Family Units	-26.0	-51.3	-41.0	-33.9	-22.1	12.8	33.0	41.8	-7.6	-17.4	-38.6	30.6	18.3
Median Home Prices													
Thousands of Dollars													
Existing Home Prices	92.2	95.9	97.1	98.3	99.4	100.6	101.7	102.9	92.9	95.2	97.7	102.3	107.3
New Home Prices	122.0	120.4	123.3	125.3	128.3	131.3	132.8	134.4	120.4	122.3	124.3	133.6	140.5
Percent Change - Year Ago													
Existing Home Prices	-0.5	0.5	0.5	1.8	7.8	4.9	4.7	4.7	4.2	2.4	2.6	4.7	4.9
New Home Prices	-2.0	-2.7	-2.6	7.3	5.2	9.1	7.7	7.3	6.2	1.6	1.7	7.5	5.1

Quarterly figures are seasonally adjusted annual rates.

* Total single-family sales equals single-family resales plus 97% of single-family housing starts.

Source: Forecast prod[illegible]ed using Laurence H. Meyer & Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Robert Barr and Kimberly Martin.

The *Real Estate Outlook* features a monthly summary of the current condition of the U.S. economy, easy-to-read forecasts for the economy and real estate, and selected reports on issues affecting the housing industry. In addition, one of the nation's top real estate economists, Dr. John Tuccillo, gives his commentary on the state of the economy and its implications for real estate markets.

If you would like to subscribe to the *Real Estate Outlook*, contact the Forecasting and Policy Analysis Division at (202) 383-1131. The annual subscription fee is $25 for members of the NATIONAL ASSOCIATION OF REALTORS® and $30 for nonmembers.

Editorial questions can be directed to Robert Barr at (202) 383-7525.

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Real Estate OUTLOOK

July 1991

The recent monthly data suggest that the economy has reversed course and is ending the recession which began last July. After ten months without an advance, employment at private, nonfarm establishments increased by 101,000 workers in May. Auto sales and durable goods orders are up, and industrial production has increased in the past two months However, the recovery's progress is expected to be fitful, its pace restrained. Commercial real estate and multifamily construction remain as drags on the economy, and consumers continue to carry high debt burdens. *Page 2*

In May, housing starts increased two consecutive months for the first time this year. After rising 8.2% in April, starts increased 0.1% to an annual rate of 982,000 units. May's weak increase is characteristic of the budding recovery, which is slow but forthcoming. *Page 4*

Sales of existing homes continued to build momentum in May, rising 6.0% to an annual rate of 3.51 million units. This is the highest sales rate since December of 1989. The gain was evenly distributed among the Midwest, South and West, with each region's sales increase averaging near 7.0%. The Northeast was the only region that did not post a gain in May. *Page 6*

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Lessons From the Old World

by John A. Tuccillo
Chief Economist and Senior Vice President
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At the end of June, what Napoleon and Hitler were unable to do with their grand armies and fleets was accomplished by a bunch of laborers with some drilling equipment. The completion of the tunnel linking England and France under the Channel (thus, the "chunnel") was not only an engineering feat, but also a powerful symbol, a fitting prelude to the pending economic unification of Europe next year.

On this side of the pond, we watch the looming merger with both curiosity and dread, mostly because the premier free market country in the world is afraid to compete with the rest of the world. We are afraid that the European behemoth, together with the surging Asian economies, will sandwich and squeeze us into permanent second world status.

Of course, this is precisely the wrong attitude. We need to observe the European experiment, but not fear it. As is the case in most undertakings of this sort, it will fail. As close as they may be, none of these countries will be willing to part with the key parts of their sovereignty, including their monetary unit. So complete integration will not happen. Moreover, the commitments to rebuild the East assumed by the unified German government will severely hamper its ability to participate in a greater Europe.

From our side, there are lessons here, even though much of what is happening is irrelevant. If we look at Europe as a single nation with a bunch of states, a lot of what it is seeking to achieve is old hat in the U.S. The free passage of goods from France to Spain is really no different from the movement between Oklahoma and Arkansas. Common financial terms are no big deal in the United States, yet will be an important accomplishment of Europe '92.

But the very concept of unification is something we need to look hard at. Recently, the Congress was faced with the question of whether we would "fast track" a *de facto* free trade area with Mexico. Opposition came from those elements that feared the displacement of American labor by lower paid Mexican workers (there's that competition thing again!). Although the measure ultimately passed, the uneasiness about lowering the barriers remains.

Ironically, the French and Germans were faced with precisely the same choice. Opening up to the rest of Europe would require competition with less expensive Irish dairy products, with continental farmers the losers. But there's a second side to this process, because as Irish incomes rose, so would the demand for German electronics products and French clothing, with continental manufacturers the winners.

We are in a similar position, but have chosen to protect rather than to grow. Yes, a free trade zone with Mexico would have a negative impact on certain industries, but the net change in total employment that would come from increased demand by Mexican workers for U.S. manufactured goods would be positive. We are the natural supplier for one of the fastest growing populations in the world, and a free trade arrangement will create the effective demand for that supply.

The Europeans have realized this relationship and are acting on it. Economic integration is not a win-win proposition; but in most cases, the winners outnumber the losers. It is very difficult to ignore the cries of the losers, but in an evolving economy growth areas must be fed, even at the expense of some traditionally important sectors.

European economic integration is important, and Asian economic growth is impressive. Yet, neither can stand up to a North American free trade area that capitalizes on the natural resource base of Canada, the productive might of the United States and the scope of the Mexican market. This is the opportunity that faces us if we take the European lesson to heart.

The second lesson from the European case centers on that tunnel. In one sense, it's a luxury item, a convenience for those who've never been to Spain, but kinda like the music. But, in a larger sense, it represents a significant investment in reducing transportation and communications costs in anticipation of a Europe marked by completely free trade. Moreover, together with the high speed rail systems now being developed throughout the continent, the tunnel was "appropriate technology," a capital project well suited to the scale of its need.

And it wasn't easy. The tunnel was expensive and time consuming; its rewards will not come instantaneously. The U.S. economy faces the same types of needs as were met by the "chunnel" in that our infrastructure is aging and in gross need of overhaul and reconstruction. Yet, those expenditures will not pay off tomorrow; rather, they require a longer view and a spending discipline that is not necessarily in vogue in this country now. We are at a crucial economic breakpoint. The recession is over, but the recovery will be weak. In fact, the last quarter of recession may be indistinguishable from the first quarter of recovery. Moderate interest rates and relatively low inflation will foster renewed growth that will continue through 1992.

But the nagging question remains: Where next? It's fairly clear that we don't need another 80's type boom that left us overburdened with both debt and bad economic habits. The larger danger, though, is that we slip into the malaise of the late 70's with slow growth and economic inefficiency. The key to avoiding that is to think in global terms, get away from the narrow parochialisms of the past and learn the lessons of the old world.

Outlook for the Economy

The recovery has made its first, halting steps. Housing markets and auto sales have rebounded in recent months, orders for durable goods are up, industrial production has increased in the past two months, and workers are putting in more hours. Inflation has lost some steam, and short-term interest rates remain low. The data are tentative but, taken together, suggest that the economy has reversed course and is ending, if it has not done so already, the recession which began last July.

The recovery's progress is expected to be fitful, its pace restrained. In fact, the recovery may yet pull up lame, sending the economy into another recessionary dip. Commercial real estate and multifamily construction remain as drags on the economy, governments at all levels are facing a fiscal squeeze, and consumers continue to carry high debt burdens. Long-term interest rates, meanwhile, have stubbornly returned to the same level they were at a year ago. A double-dip of recession wouldn't be unusual; in three of the previous four recessions, there has been a quarter of positive growth before output turned negative once again.

According to NAR's forecast, the return of consumer spending will provide an important toehold for the recovery. In late July, the first figures for GNP growth in the second quarter will be released, and NAR projects they'll show a meager 0.7% annual rate of increase. This will be a transitory quarter for the economy, coming between a 2.8% annual rate of decline in the first quarter of 1991 and an estimated 2.4% rate of growth in the second half of the year. For 1991 as a whole, the economy is projected to decline 0.2% over 1990.

A Green Light from Recent Statistics

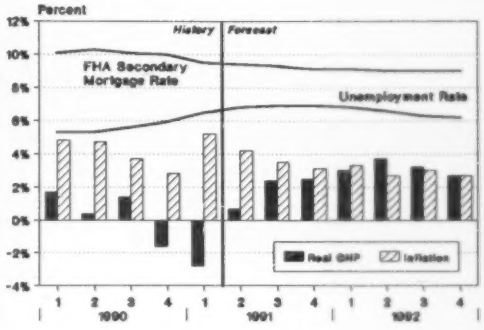
After ten months without an advance, employment at private, nonfarm establishments increased by 101,000 workers in May (revised up from the 49,000 gain previously reported). Indicative of the "two steps forward, one step back" nature of this recovery, the payroll level in June reversed course, declining by 39,000 workers (see chart). But the June report also contained good news in that the average workweek expanded significantly, a usual precursor of increased hiring. Meanwhile, industrial production rallied in April and May and appears to have turned the corner, although it remains 4% below September 1990's peak (see chart). Orders for durable goods have also grown smartly in the past couple of months, one of several measures signalling business's renewed confidence in the health of the economy.

Will the Increase in Consumer Spending Last?

One source of renewed strength in output is consumer spending. After declining at a 2.4% pace in the six months between October and March, consumer spending is projected to have bounced back to a 3.7% annual rate between April and June. Consumers, who held back during the buildup to the Persian Gulf war, increased their spending sharply on durable goods, especially autos, in the second quarter. But once this pent-up demand is dissipated, consumers may again cut back since recent income gains have not been strong enough to support such spending.

For example, in the first five months of 1991, personal spending, after accounting for inflation, rose at a 1.9% annual rate. Income, after adjusting for inflation and taxes, fell at a

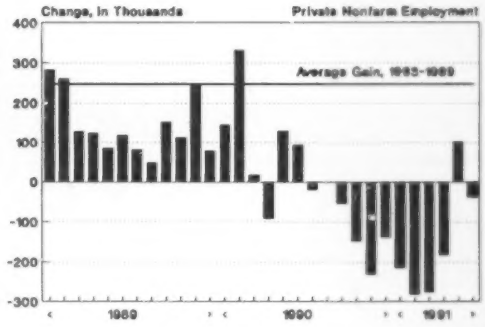
The Economic Outlook



Sources: BEA, BLS, FHLMC, NAR forecast

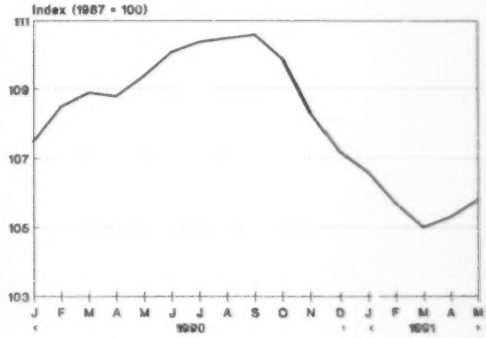
Employment Falters in June

But May's Gain Suggests Recovery Is at Hand



Source: Bureau of Labor Statistics

Industrial Production Turns the Corner in April and May



Source: Federal Reserve

1.0% rate over the same period (see chart). Looking at just the last three months, the gap between spending and income has widened. Although income growth has turned positive, (up a scant 0.3%), spending advanced at a 3.8% rate.

Given this divergence, it's not surprising that the saving rate has fallen, averaging 3.7% in the past three months relative to 4.9% in the same period a year earlier. A falling saving rate and an already high debt burden suggest that the recent strength in consumer spending will be short-lived. This is one major reason why the first two quarters of this recovery are expected to be so sluggish relative to previous recoveries. It also makes predictions of a double-dip plausible, even if not convincing.

There remain important structural shifts in the economy which will also limit performance between now and year-end. The real estate industry remains weak, with multifamily and commercial construction in the doldrums. The defense industry is gearing down, and retailing and financial services are undergoing fundamental shakedowns in their industrial structures. But as resources move away from these areas, they will shift into areas that are (or are expected to be) more profitable. Such sectors that may benefit include the production of capital equipment, exported goods, and single-family residences. The transition will be difficult for affected industries and individuals, but the overall impact on the economy will be positive.

Slower Inflation Improves Recovery's Chances

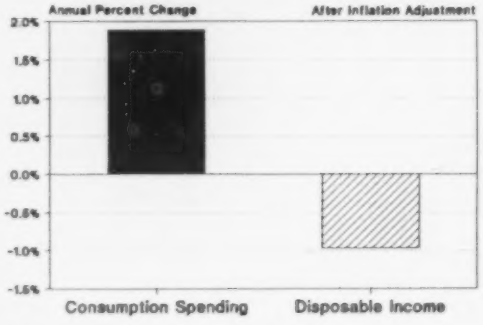
The Consumer Price Index, after excluding the volatile food and energy components, has shown only mild increases in the past three months. As shown in the accompanying chart, this is in contrast to the first two months of 1991. One of the silver linings to be found in recessions is a lower inflation rate, and this recession will not be an exception. The slack in the labor market, represented by June's 7.0% unemployment rate, will temper wage increases and help keep a lid on inflation. The CPI is projected to increase 4.3% in 1991, down from 5.4% in 1990. Improvement is expected to continue in 1992, with a CPI gain of 3.3%.

Since long-term interest rates take account of inflation, then less inflation should allow these rates to fall. A decline in long-term rates would provide relief to interest-sensitive sectors of the economy, such as home-building and the production of capital equipment and durable goods. This would also help the frayed banking sector. The chart at right shows how 30-year mortgage rates have bounced back up recently while adjustable rate mortgages, less dependent on long-term rates, have held steady.

After engineering the sharp fall of short-term rates over the past several months and continuing its vigilance over inflation, the Fed has done about all it can do to lower long-term rates. What's needed is a market convinced that inflation will remain in check. The recent reappointment of Alan Greenspan to head the Federal Reserve Board for another four years will please the financial markets, no doubt. Not complacent with the prevailing 4% inflation rate seen since the early 1980s, Greenspan's Fed has been shooting for price stability, or zero inflation, and, more importantly, has been willing to trade off some current economic pain today for greater economic growth tomorrow.

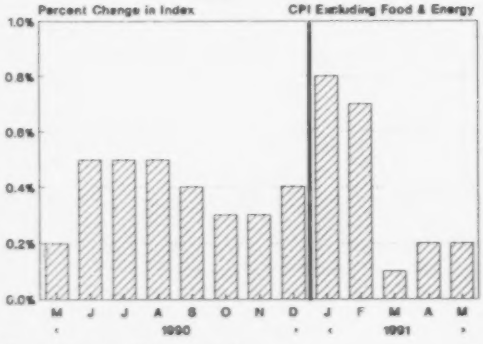
Spending's Up Even as Income Falls

Changes Over the First Five Months of 1991



Source: Bureau of Economic Analysis

Recent Inflation Performance Improves



Source: Bureau of Labor Statistics

Mortgage Rates Diverge

Growing Gap Reflects Inflation Worries

Source: Federal Home Loan Mortgage Corporation

Housing Starts

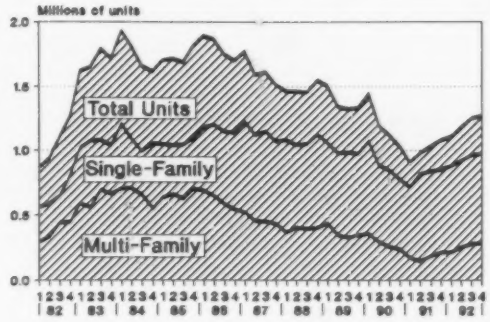
National Data

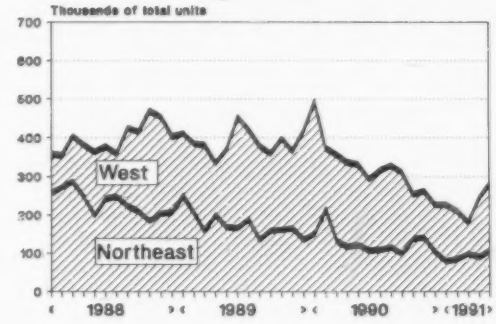
	Total	SF	MF:2-4	MF:5+
May 1990	1,208	897	38	273
Dec 1990	971	751	17	203
Jan 1991	847	648	29	170
Feb 1991	992	788	37	167
Mar 1991	907	742	28	137
Apr 1991	981	807	33	141
May 1991	***982***	***832***	***32***	***118***
Annual Averages:				
1989	1,381	1,005	56	320
1990	1,203	901	37	265
Percent Changes in May 1991 since:				
May 1990	-18.7	-7.2	-15.8	-56.8
Apr 1991	0.1	3.1	-3.0	-16.3

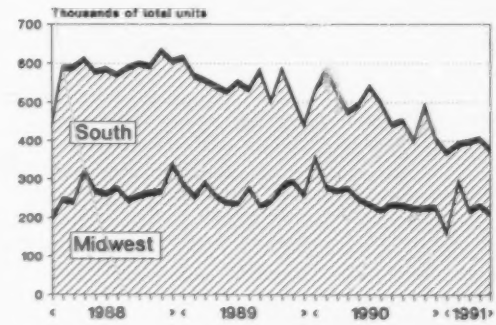
Regional Data

	Northeast	Midwest	South	West
May 1990	128	255	486	339
Dec 1990	110	233	395	233
Jan 1991	86	167	361	233
Feb 1991	91	301	384	216
Mar 1991	104	226	390	187
Apr 1991	96	238	397	250
May 1991	***113***	***217***	***367***	***285***
Annual Averages:				
1989	181	269	535	397
1990	135	259	478	330
Percent Changes in May 1991 since:				
May 1990	-11.7	-14.9	-24.5	-15.9
Apr 1991	17.7	-8.8	-7.6	14.0

Levels are seasonally adjusted annual rates, in thousands.
Source: Bureau of the Census, Construction Reports, Series C25







In May, housing starts increased two consecutive months for the first time this year. After rising 8.2% in April, starts increased 0.1% to an annual rate of 982,000 units. May's weak increase is characteristic of the budding recovery, which is slow but forthcoming. All of the increase came from the strength in the construction of single-family homes, which grew 3.1% to 832,000 units. This is the highest level for single-family starts since October of 1990. The construction of multifamily homes continues to be limited by the lack of credit. Consequently, a 13.8% decline in the construction of multifamily homes partially offset the advances made in the single-family market.

Activity in the four Census reporting regions varied in May. In the Northeast region, where the recession has taken the heaviest toll, construction appears to be bouncing back. There, housing starts grew a lofty 17.7% to 113,000 units. In the West, starts increased 14.0% to 285,000 units. Countering these increases were declines in the Midwest and the South. In the Midwest, starts declined 8.8% from April to 217,000 units, and in the South starts dropped 7.6% to 367,000 units.

Low mortgage rates and the belief that the end of the recession is at hand give second quarter starts a healthy 8.2% gain over the first quarter's rate. During the third quarter of 1991, starts are expected to reach the one million mark. Economic expansion and the easing of the credit crunch are expected to pull multifamily starts up by 39.2% and single-family starts up at a 15.7% clip in 1992. In 1992, total starts are projected to be 20.3% higher than in 1991.

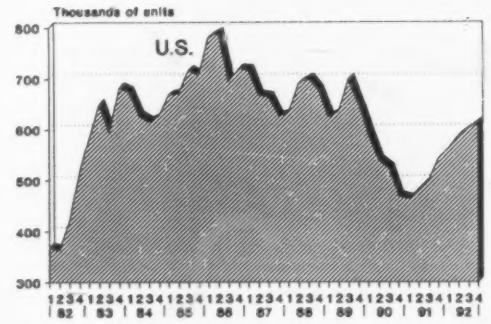
National Data

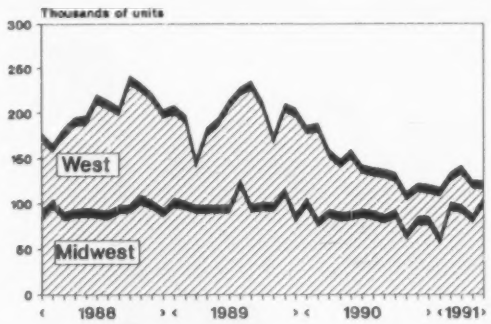
		Mo. Ago % Chg.	Yr. Ago % Chg.
May 1990	535	0.2	-17.8
Jun 1990	549	2.6	-15.0
Jul 1990	541	-1.5	-27.0
Aug 1990	525	-3.0	-27.0
Sep 1990	504	-4.0	-21.0
Oct 1990	465	-7.7	-26.9
Nov 1990	480	3.2	-30.1
Dec 1990	464	-3.3	-26.7
Jan 1991	414	-10.8	-34.0
Feb 1991	488	17.9	-19.5
Mar 1991	491	0.6	-12.2
Apr 1991	490	-0.2	-8.2
May 1991	***474***	***-3.3***	***-11.4***
Annual Averages:			
1989	654		-3.3
1990	534		-18.3

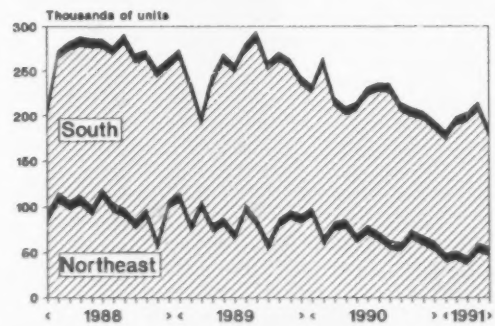
Regional Data

	Northeast	Midwest	South	West
May 1990	70	91	215	159
Dec 1990	62	86	195	121
Jan 1991	49	65	183	118
Feb 1991	52	102	199	134
Mar 1991	46	99	203	142
Apr 1991	60	88	215	126
May 1991	***56***	***107***	***187***	***125***
Annual Averages:				
1989	90	103	258	202
1990	75	90	222	147
Percent Changes in May 1991 since:				
May 1990	-20.0	17.6	-13.0	-21.4
Apr 1991	-6.7	21.6	-13.0	-0.8

Levels are seasonally adjusted annual rates, in thousands.
Source: Bureau of the Census, Construction Reports, Series C25







Activity in the new home sales market stood in contrast to other areas of housing during May. Unlike the pace of housing starts and existing home sales, the pace of new home sales dropped 3.3% to an annual rate of 474,000 units. In all likelihood, builders are being hampered by the continued lack of credit, which is, in turn, causing stagnation in the new home sales market.

Of the four regions, only the Midwest recorded an increase in the sale of new homes. There, sales climbed 21.6%, pushing the annual rate over the 100,000 mark and 17.6% above the rate of a year ago. The South encountered the greatest loss, with new home sales tumbling 13.0%, or 28,000 units. The Northeast saw new home sales fall 6.7% to an annual rate of 56,000 units, while the West saw sales slip 0.8% to 125,000 units.

Despite the decline in new home sales, May's figures continue to support the view that January's poor performance will be the nation's low point. With the approaching recovery, new home sales in the second quarter are expected to post a healthy 4.1% gain over the first quarter's rate. During the third quarter of 1991, new home sales are expected to exceed the half-million mark. As the fourth quarter comes to a close, new home sales will have increased 17.0% from the first quarter, which translates into a gain of 79,000 units.

By 1992, new home sales will be poised for growth. As the economy continues to expand and the lending environment loosens, new home sales are forecast to increase 18.8% in 1992. Thereafter, sales will begin to stabilize, and are projected to increase 6.8% to 632,000 units in 1993.